

Michigan Public School Employees Retirement System

A Pension and Other Employee Benefit Trust Fund of the State of Michigan

Annual Supplemental Report for Fiscal Year 2012



Prepared by
The Office of Retirement Services
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About the Michigan Public School Employees Retirement System

This report is in compliance with Public Act 300 of 2012. The contents came from the complete 2012 Comprehensive Annual Financial Report (CAFR), an existing public data source available on our website at www.michigan.gov/schools, and additional analysis performed after September 30, 2012.

The Michigan Public School Employees Retirement System serves 196,661 retirees receiving monthly benefits, and 223,769 active members. Public school employees' pensions are protected by Michigan's Constitution. The Office of Retirement Services' net assets are held in trust to meet future benefit payments.

Assets & Liabilities*

System total assets as of September 30, 2012, were \$43.8 billion and were mostly comprised of cash, investments, and contributions due from employers.

Total liabilities as of September 30, 2012, were \$4.2 billion and were comprised of accounts payable, deferred revenue, and obligations under securities lending.

System assets exceeded its liabilities at the close of fiscal year 2012 by \$39.6 billion. Total net assets held in trust for pension and Other Post-Employment Benefits (OPEB) increased \$3.5 billion or 9.6 percent from the previous year, primarily due to net investment gains. This compares to fiscal year 2011, when net assets decreased by \$0.7 billion or 2.0 percent from the prior year.¹

Assets & Liabilities* (combined pension and healthcare)		
	<u>FY 2012</u>	<u>FY 2011</u>
<u>Assets</u>		
Cash	\$ 152,974,513	\$ 121,128,520
Receivables	354,391,408	347,204,691
Securities Lending Collateral	3,043,514,865	4,243,653,251
Investments	<u>40,257,347,289</u>	<u>37,034,937,112</u>
Total Assets	\$ 43,808,228,075	\$ 41,746,923,574
<u>Liabilities</u>		
Accounts Payable and Other Liabilities	\$ 290,086,712	\$ 332,130,951
Obligations Under Securities Lending	<u>3,921,029,447</u>	<u>5,287,823,375</u>
Total Liabilities	\$ 4,211,116,159	\$ 5,619,954,326
Net Assets	<u>\$ 39,597,111,916</u>	<u>\$ 36,126,969,248</u>

*Source: CAFR for the Fiscal Year ended September 30, 2012, p. 22.

* Liabilities in this context are exclusive of Unfunded Accrued Actuarial Liabilities (UAAL) for pension and health.

¹ Source: Comprehensive Annual Financial Report (CAFR) for the Fiscal Year ended September 30, 2012.

Revenue and Expenditures

The reserves needed to finance pension and other post-employment benefits are accumulated through the collection of employer and employee contributions and through earnings on investments. Contributions and net investment income for fiscal year 2012 totaled approximately \$8.6 billion.

The primary expenses of the System include the payment of pension benefits to members and beneficiaries, payment for health, dental and vision benefits, refund of contributions to former members, and the cost of administering the System.¹

¹ Source: CAFR for the Fiscal Year ended September 30, 2012

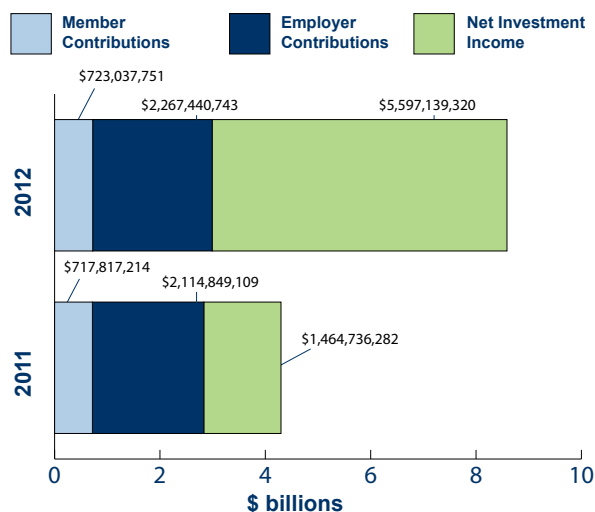
Additions & Deductions* (combined pension and healthcare)		
	FY 2012	FY 2011
Additions		
Member Contributions	\$ 723,037,751	\$ 717,817,214
Employer Contributions	\$ 2,267,440,743	\$ 2,114,849,109
Net Investment Income (loss)	5,597,139,320	1,464,736,282
Total Additions	\$ 8,587,617,814	\$ 4,297,405,605
Deductions		
Benefit Payments	\$ 4,082,242,506	\$ 3,942,027,101
Health, Dental, & Vision Benefits	823,447,206	910,023,134**
Transfers & Refunds	34,326,666	36,632,339
Administrative Expenses	178,828,004***	136,717,170***
Total Deductions	\$ 5,118,844,382	\$ 5,025,399,744
Beginning of Year Assets	36,126,969,248	36,854,803,062
End of Year Net Assets	\$ 39,597,111,916	\$ 36,126,969,248

*Source: CAFR for the Fiscal Year ended September 30, 2012, p. 23.

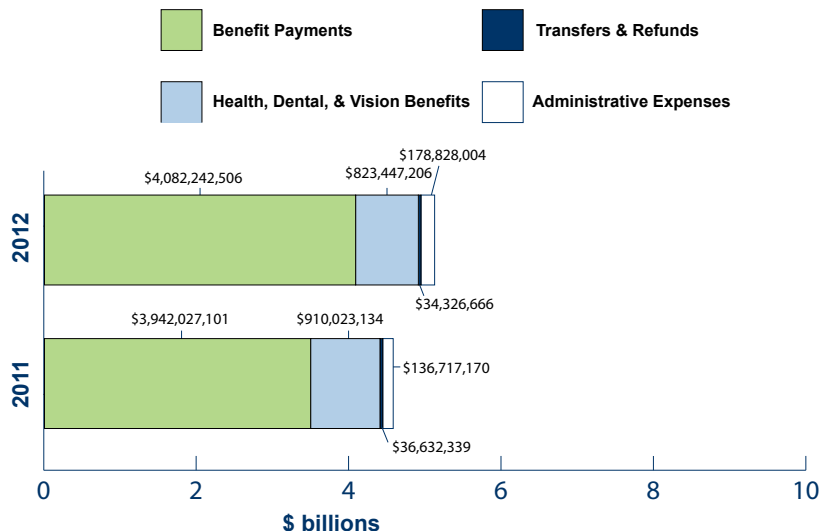
**Reflects a higher number of retirees and beneficiaries (as a result of the retirement incentive in 2010), the timing of savings associated with participation in federal programs, and inflation.

***Reflects participation in federal programs that provide a federal subsidy for eligible healthcare claims, producing a net overall savings to the retirement system.

Revenues



Expenditures



Investments & Earnings

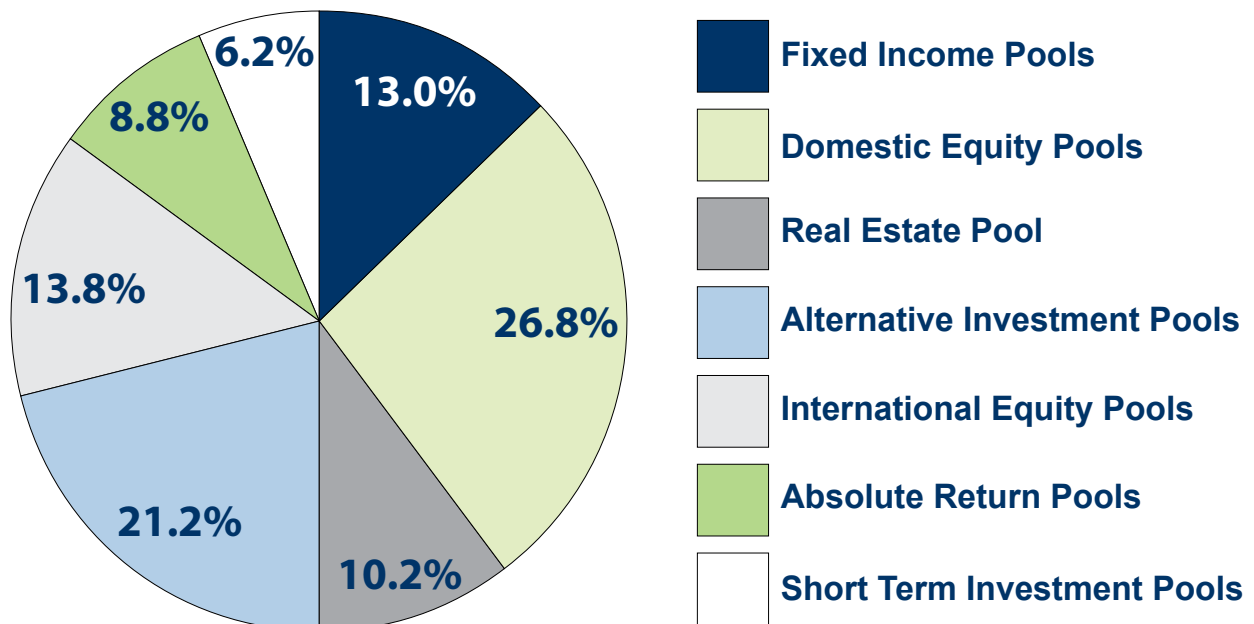
The State Treasurer administers all of the system's investments. The main objective is to maximize the return rate and meet the actuarial assumptions by being prudent with investments, and maintaining a diverse portfolio to eliminate unnecessary risk.

Why are there different types of assets in the retirement plan's portfolio? Having a diverse portfolio is like having shocks on a car. It minimizes the volatility, so the returns vary less from year to year. Even though market performance may fluctuate, the long-term performance of the retirement system's portfolio remains stable. This ensures our funds are financially sound.

Investments & Earnings*		
	Market Value	Total Investment and Interest Income
Fixed Income Pools	\$ 5,266,520,332	\$ 308,520,791
Domestic Equity Pools	10,822,248,637	2,870,712,453
Real Estate Pool	4,112,274,446	322,979,112
Alternative Investment Pools	8,584,637,944	971,985,908
International Equity Pools	5,577,606,931	785,330,934
Absolute Return Pools	3,557,917,638	229,692,949
Short Term Investment Pools	2,489,115,875	4,950,302
Market Value and Net Investment Gain	<u>\$ 40,410,321,803</u>	<u>\$ 5,494,172,449</u>

*Source: CAFR for the Fiscal Year ended September 30, 2012, p. 75.

Investment Classes



Market Funded Ratios & Actuarial Funded Ratios

Pension

The market funding ratio is based only on the market value of assets at year end. The actuarial funding ratio incorporates a 5-year "smoothing" period that reduces volatility. The actuarial funding ratio is the common metric used by all pension plans nationwide. This smoothing process is used by almost every retirement system in the country; it helps avoid volatility in the pension systems' funding requirements. As the economy improves, the funding ratio will also improve.

Healthcare

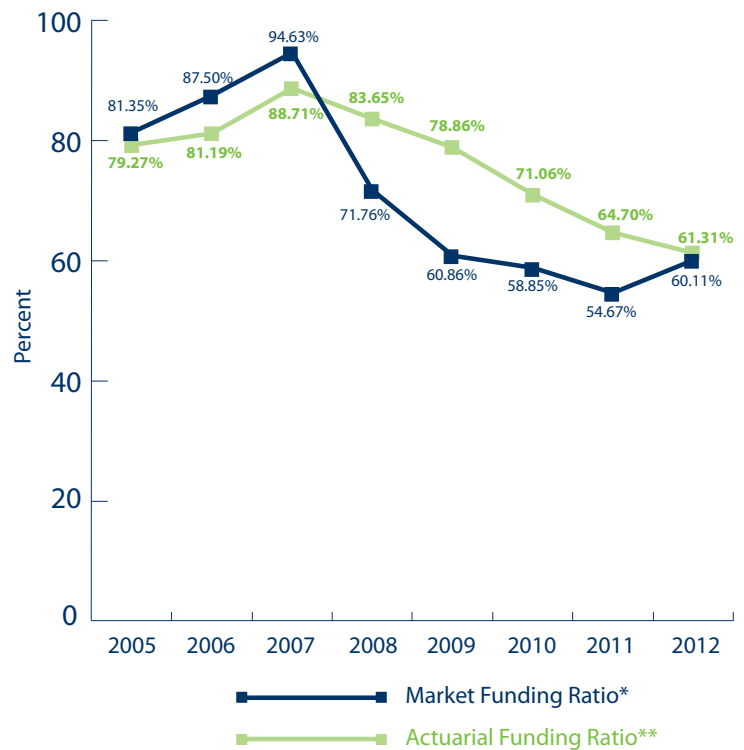
Starting in 2012, the Public School Employees Retirement System began pre-funding retiree health care costs, which significantly decreased the liability and increased the asset levels. Pre-funding is a best practice that invests assets and allows investment returns to help fund the plan - many states do not pre-fund, and this reform puts Michigan on the leading edge of retirement funding practices.

Before 2012, the system was funded on a pay-as-you-go basis, so market and actuarial funded ratio were the same. Beginning in 2011, active member contributions required by Public Act 75 of 2010 were counted in the market value, but not the actuarial value. Over time, as pre-funding and member contributions ramp up, the funding ratio will improve significantly.

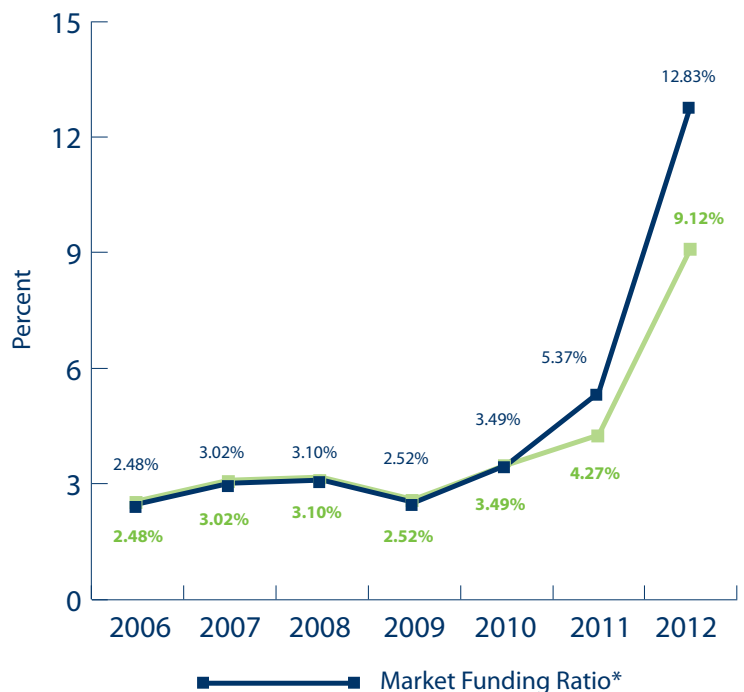
* Source: CAFR for the Fiscal Year ended September 30, 2012, p. 48

** Source: CAFR for the Fiscal Year ended September 30, 2012, p. 22

Pension



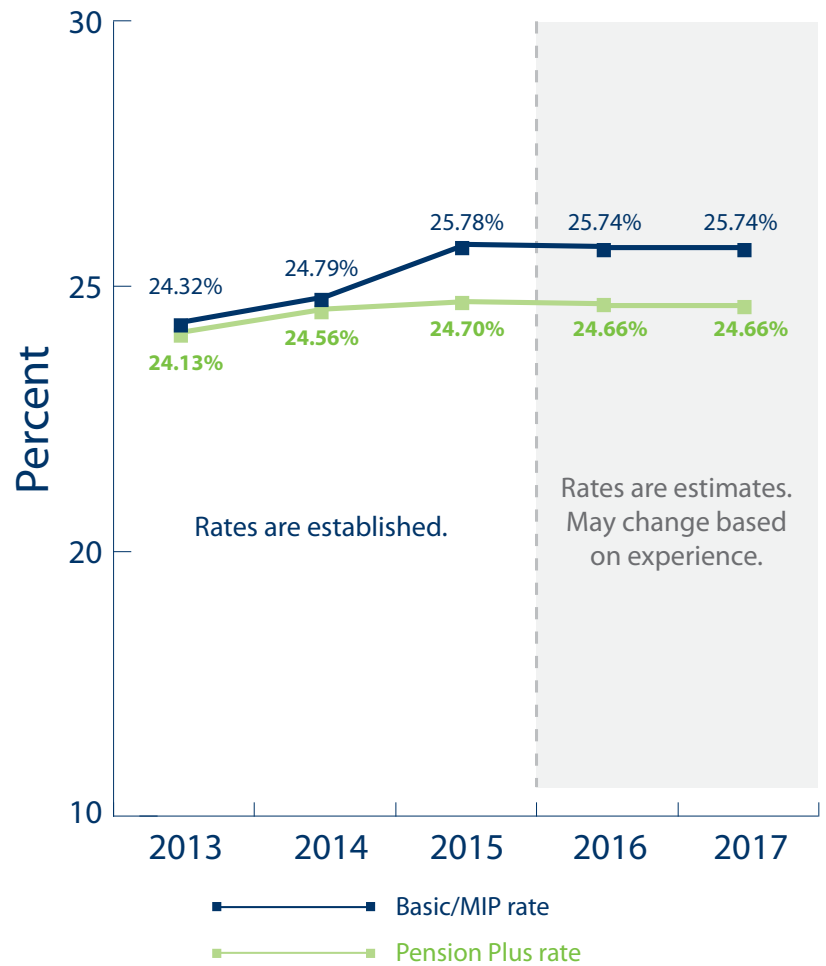
Healthcare



Contribution Rates

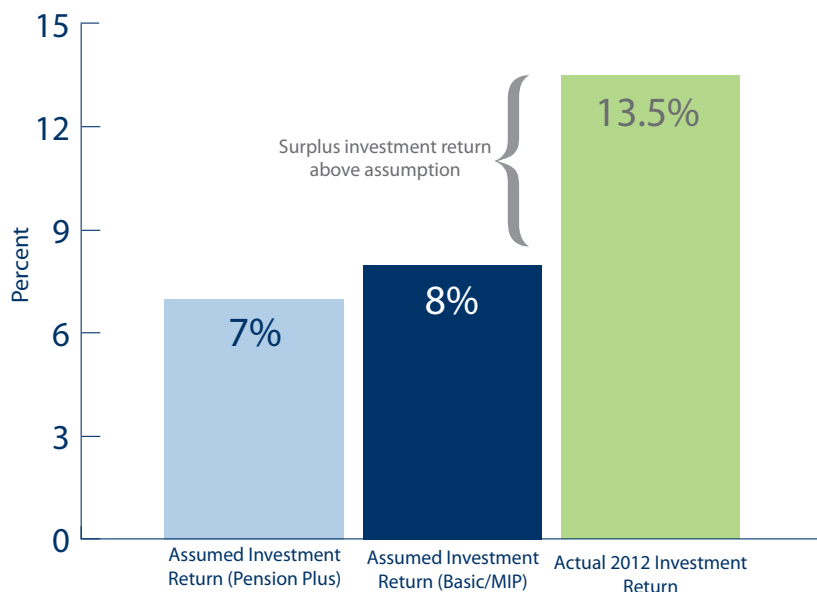
Contribution rates are determined actuarially based on the economic conditions and an assumed investment return each year. Contribution rates for fiscal years 13, 14, and 15 have been calculated, provided to the employers, and published on the employer website.

Rates for fiscal years 16 and 17 are estimated, and will be reevaluated annually.



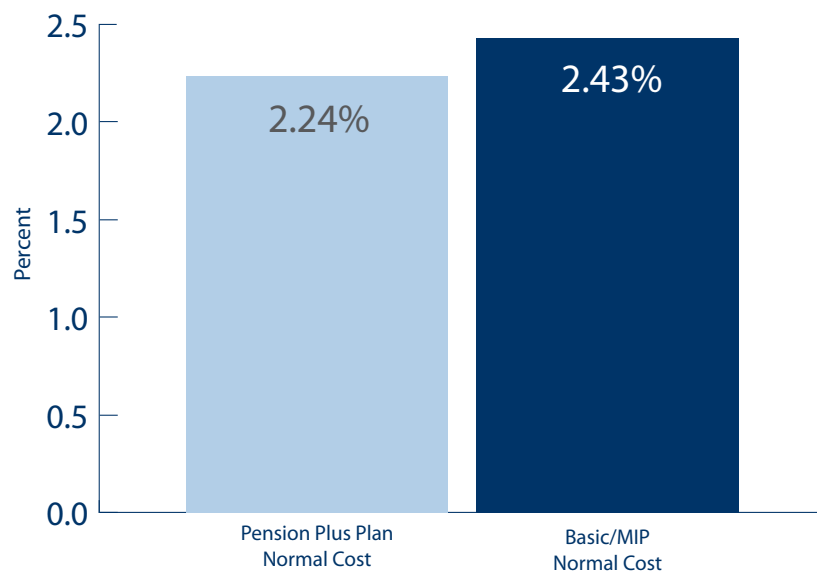
Discount Rates and Actual Investment Return

Contribution rates are determined by actuaries based on an assumed investment return each year. These assumptions are different for the Basic Plan/Member Investment Plan (MIP) and Pension Plus plan: 8 percent and 7 percent, respectively. When investments exceed the assumed rates of return, as they did in 2012, this results in a gain for the retirement system. The actual rate of investment return in FY 2012 was 13.5 percent, which is greater than the assumed rate of return.



Employer Normal Cost Contribution Rates for FY 13

Normal Cost is the actual cost of the retirement benefit a member earns each year, and is set using the assumed rate of investment return shown above in addition to other actuarial assumptions. All Pension Plus members, all MIP members, and some Basic members contribute toward the cost of their retirement benefits. After member contributions are accounted for, the employer pays the remainder of the Normal Cost as shown here.



Office Closures

May 27 - Memorial Day
July 4 - Independence Day
September 2 - Labor Day

Our website is available seven days a week, even when our office is closed: www.michigan.gov/orsschools

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